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Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443, 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

EL PASO NATURAL GAS COMPANY,

PACIFIC GAS AND ELECTRIC COMPANY AND SOUTHERN CALIFORNIA GAS COMPANY

and

THE FEDERAL ENERGY REGULATORY COMMISSION,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

THE PUBLIC UTILITY COMMISSIONER OF OREGON, *et al.*

and

NORTHWEST PIPELINE CORPORATION, *et al.*,
Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, *et al.*,
Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENTS TENNECO OIL COMPANY, *ET AL.*

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May 11, 1984

QUESTIONS PRESENTED

1. Whether the transfers of title to leasehold interests in the 1950's, where the underlying reserves did not meet the *Rayne Field* standard of "proven and substantially developed" so as to be "imminently capable of producing gas in commercial quantities," and the transfers were not the "economic equivalent" of sales of gas, constitute jurisdictional sales of natural gas.

2. Whether Section 2 (22) of the Natural Gas Policy Act of 1978 provides a new basis for reviewing transfers of title to leases after December, 1978, thereby rendering the decision of the Court of Appeals prospectively moot.

3. Whether the effect of this Court's decision in *Mid-Louisiana* renders the Court of Appeals decision prospectively moot.

PARENT COMPANIES, SUBSIDIARIES AND AFFILIATES OF RESPONDENT CORPORATIONS

Parent Companies, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Tenneco Oil Company:

Tenneco Corporation
Tenneco Inc.
Akulu Chemicals (PTY) Ltd.
Akulu Marchon (PTY) Ltd.
Albright & Wilson (Australia) Ltd.
Albright & Wilson Match Phosphorus Co. Ltd.
Arndale Fuels Ltd.
Bracey Petroleum Products Ltd.
Butler Oil Products Ltd.
Case Poclain GmbH & Co.
Collins Pipeline Company
Depositas Del Norte, S.A.
FC Marine Inc.
HT Gathering Company
Intertrac A.G.
Intertrac America Corporation
Intertrac G.B. Ltd.
Intertrac Italiana S.R.L.
Intertractor Viehmann GmbH & Co.
J.I. Case do Brasil & Cia.
Kern Island Water Company
Kern River Canal and Irrigating Company
Losenhausen Maschinenbau AG
Losenhausen Maschinenbau AG & Co.
Marchon-Paragon Holdings (PTY) Ltd.
Marchon-Paragon Sulphonation (Cape) (PTY) Ltd.
Marchon-Paragon Sulphonation (PTY) Ltd.
Meadows of the Kern Mutual Water Company
Mistal Inc.
Monroe Auto Pecas S.A.
Omni-Pac GmbH
P.P.M. Guindastes Hidraulicos S.A.
Poclain S.A.

Polyphosphates Inc.
S.A. Paper Chemicals (Proprietary), Limited
Sara Gretes Cafeteria AB
Skogstrea A/S
Societe Anonyme Industrielle de Resines
Stockdale Coffee Company
Stoco Mutual Water and Sewer Company
T & M Terminal Company
TENN-USS Chemicals Finance Corporation
Tees Storage Company Limited
Tenneco Oil Company of Nigeria Unlimited
Tenneco Property Corporation
Tenngasco Gas Gathering Company
Tractortechnic Canada, Ltd.
Universal Chemical Contractors (PTY)
Uplands of the Kern Mutual Water Company
Vibromax Australia (PTY) Ltd.
Vibromax France SARL
Vibromax SCI
W. R. John & Company (Rumney) Ltd.

Parent Company, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Conoco Inc.:

E.I. duPont de Nemours and Company
Cit-Con Oil Corporation
Conch International Methane Ltd. (Bahama Islands)
Conch L.N.G.
Conoco Exploration, Ltd.
Bishop Coal Company
Conrhein Coal Co. (Partnership)
Cardinal River Coals, Ltd. (Alberta, Canada)
Neptune Bulk Terminals (Canada) Ltd. (Canada)
Contochu Inc.
Harmar Coal Co.
Itmann Coal Co.
Tongue River Railroad (Partnership)
Oasis Oil Co. of Libya, Inc.

Colonial Pipeline Company
Dixie Pipeline Company
Explorer Pipeline Company
Lake Charles Pipe Line Company
Pioneer Pipe Line Company
Platte Pipe Line Company
Seadock, Inc.
Texas Offshore Port, Inc.
West Shore Pipe Line Company
Yellowstone Pipe Line Company
Kettleman North Dome Assoc.
Maritime Protection Inc.
Oil Shippers Service, Inc.
Petroleum Terminals, Inc.
Iricon Agency, Ltd.
Southern Facilities, Inc.
The Standard Shale Products Company

Parent Companies, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of American Petrofina Company of Texas:

American Petrofina, Incorporated
Petrofina Delaware, Incorporated
American Petrofina Exploration Company
American Petrofina Holding Company
Petrofina, S.A. (Belgium)
Cos-Mar, Incorporated
Mid-County Chemical Company
Fina Supply Inc.
American Petrofina Marketing Inc.

Parent Company, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Delta Drilling Company:

Perforadora Central, S.A. de C.V. (Mexico)
Grupo Constructor Central, S.A. de C.V. (Mexico)
Delta Marine Drilling Company

Tripart (I) Corp.
Tripart (II) Corp.
Tripart (III) Corp.
Tripart (IV) Corp.
Tripart (V) Corp.
Tripart (VI) Corp.

Parent Company, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Sun Exploration and Production Company:

Sun Company, Inc.
Alaska Bulk Carriers, Inc.
Hemisphere Oil Company. Inc. (Puerto Rico)
Mid-Valley Pipeline Company
Suncor, Inc. (Canada)
Lugrasa, S.A. (Panama)
Nuestro Publications, Inc.
Vessey Chemicals Pty. Ltd. (Australia)
Carboline GMBH
Carboline Coatings Ltd. (New Zealand)
Carboline Southeast Asia Ltd. (Singapore)
Taranaki Blast Services Ltd. (New Zealand)
Japan Carboline Company (Japan)
Carboline Europe (France)
Carboline S.A. de D.E.C.V. (Mexico)
Lavan Petroleum Company (Lapco) (Iran)
Japan Sun Oil Company, Ltd. (Japan)
Glacier Bay Transportation Corporation
Oil Insurance Limited (Bermuda)
Becton, Dickinson and Company
Canyon Reef Carriers, Inc.
East Texas Salt Water Disposal Company
Van Salt Water Disposal Company
Deepsea Ventures, Inc.
Explorer Pipeline Company
Texoma Pipeline Company
West Texas Gulf Pipeline Company

Sun Olin Chemical Company
International Biomedical Instruments, Inc.
VLM Corporation
Nova (an Alberta Corporation) (Alberta, Canada)
Nottingham Gas Limited (Saskatchewan, Canada)
Redwater Water Disposal Company Limited (Alberta, Canada)
Sultran Ltd. (Alberta, Canada)
Sun-Canadian Pipeline Company Limited (Ontario, Canada)
Solartech Limited (Canada)
Trilliun Exploration Corporation (Canada)
Sundata Corporation
Petromech Svn. Bhd. (Malaysia)
Sunoco de Chile Ltda. (Chile)
Venezoil C.A. (Venezuela)
White River Shale Oil Corporation
Tretol Ltd. (United Kingdom)

Parent Companies, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Atlantic Richfield Company:

[Listed in the separate "Brief in Opposition of the PLA Respondents" filed in these cases]

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443, 83-1618

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
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ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENTS TENNECO OIL COMPANY, *ET AL.*

Respondents Tenneco Oil Company, *et al.*[1] respectfully suggest that this Court deny the petitions for a writ of certiorari

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[1] The Respondents joining in this Brief in Opposition are Tenneco Oil Company, Conoco Inc., American Petrofina Company of Texas, Crown Central Petroleum Corporation, Delta Drilling Company,

seeking review of the decision of the United States Court of Appeals for the Fifth Circuit in this case. That opinion is reported at 708 F.2d 1011.[2]

ADDITIONAL STATUTORY PROVISION INVOLVED

In addition to Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) (1982), certain Petitioners have invoked Section 2(22) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301(22) (1982). That provision states as follows:

> DELIVER.—The term "deliver" when used with respect to any first sale of natural gas, means the physical delivery from the seller; except that in the case of the sale of proven reserves in place to any interstate pipeline, any intrastate pipeline, any local distribution company, or any user of such natural gas, such term means the transfer of title to such reserves.

STATEMENT OF THE CASE

Respondents are corporations, individuals, partnerships, trusts and estates who are royalty owners, not producers or sellers of natural gas. These cases were brought by El Paso Natural Gas Company ("El Paso") and Northwest Pipeline Corporation ("Northwest"), which are and have been the producers and sellers of gas under the agreements here at issue, in an effort to convert the royalty owners into jurisdictional sellers of natural gas.

In the early 1950's El Paso decided to build a pipeline to tap a new gas field. It acquired what the Federal Power Commis-

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Mr. and Mrs. Morris Mizel, Sun Exploration and Production Company, Atlantic Richfield Company, F.H.N., Ltd., W. Watson LaForce, Jr., *et al.* and Robert Beamon, Individually and as Trustee, Thomas L. Hail, Trustee and Pattie Ann Beamon Lundell (the "Beamon Parties").

[2] References in this Brief in Opposition to specific pages of the Court of Appeals decision and to specific pages of the other decisions below will be to the Appendix ("App.") filed with the Petition of The People of the State of California and The Public Utilities Commission of the State of California ("California") in No. 83-1321. References to the various petitions will be in the form "California Pet. at ____."

sion[3] described as "large, undeveloped acreage" from Delhi Oil Corporation.[4] *William G. Webb*, 49 F.P.C. 17, 18 (1973). Then and thereafter hundreds of thousands of acres of gas leases in the San Juan Basin area of New Mexico were acquired by El Paso, most of the leases with either a few wells or no wells drilled thereon. Since then, some 3,200 wells have been drilled by El Paso on the subject lease sale acreage.[5]

To acquire the leases so that El Paso could be the producer as well as the pipeline, it promised to pay a royalty to the former owners of the various leases, if gas were found pursuant to the drilling program to be conducted by El Paso. El Paso paid nothing for the leases; there was no purchase price based upon reserves in place, App. 127a, unlike *Rayne Field*,[6] *Bastian Bay*,[7] and *Ship Shoal*.[8]

El Paso presented the lease sale agreements to the Commission in both rate and certificate cases commencing in 1952.[9]

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[3] The Federal Power Commission and its statutory successor, Petitioner Federal Energy Regulatory Commission, will be referred to hereinafter as the "Commission."

[4] Delhi Oil Corporation is the predecessor-in-interest of Respondents Tenneco Oil Company and Conoco Inc. under the first and largest of the lease sale agreements at issue herein, commonly referred to by the parties as "GLA-47." *See* App. 9a.

[5] *See* "Proposed Findings of Fact and Conclusions of Law of El Paso Natural Gas Company" at 4, El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist. Ct. Harris County, Texas, 11th Jud. Dist., filed March 21, 1984).

[6] United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965) ("Rayne Field").

[7] Pan American Petroleum Corp. v. FPC, 339 F.2d 694 (10th Cir. 1964), *rev'd*, 381 U.S. 762 (1965) ("Bastian Bay").

[8] Continental Oil Co. v. FPC, 370 F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967) ("Ship Shoal").

[9] Immediately after the closing of GLA-47, the President of El Paso explained the transaction in detail in sworn testimony before the Commission. R. 7991-8007.

Most of the agreements were never challenged by the Commission or any party. Those that were challenged were found by the Commission, in 1973, in a final order, to constitute genuine lease sales and not to constitute sales of gas under the *Rayne Field* doctrine. *Webb*, 49 F.P.C. at 26.[10]

For some twenty years El Paso operated the lease sale properties, drilled the wells, claimed all producer federal income tax benefits, paid the royalties and collected for itself a profit, or return, on the sales of gas to its customers, a profit being impermissible if the lease sales were a "sham" or *Rayne Field* transaction. As a pipeline producer, El Paso was permitted by the Commission to include the overriding royalties in the cost of service charged in the rates to its customers as costs "prudently incurred," and collected a return on investment, depreciation, and other charges that cannot be collected by the pipeline if the gas is purchased from independent producers.

The time came to increase the royalty payments, as agreed in the lease sale agreements.[11] El Paso resisted and, only nine months after succeeding before the Commission in arguing to the contrary, El Paso sued in federal court[12] to have Respondents declared sellers of gas under the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982), hoping to mitigate the royalty payments. The next year El Paso raised the same issue at the Commission, which declined to proceed until after the federal

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[10] El Paso argued in *Webb* that the lease sale agreements were *not Rayne Field* transactions. R. 17426-31.

[11] The agreements contained an arbitration clause that applied if the parties could not agree upon the amount of the redetermined overriding royalty. Pursuant to that clause, a Board of Arbitration set the overriding royalty for GLA-61, the lease sale agreement between El Paso and Sun Oil Company (Delaware), predecessor of Respondent Sun Exploration and Production Company. App. 129a.

[12] Section 22 of the Natural Gas Act, 15 U.S.C. § 717u (1982), confers exclusive jurisdiction over actions to enforce any duty created by the Natural Gas Act in the District Courts of the United States.

court had rendered its decision. *See El Paso Natural Gas Co.*, 55 F.P.C. 1677 (1976).[13]

El Paso settled the amount of the overriding royalty with the royalty owners, agreeing to pay the overriding royalty regardless of whether the Commission would authorize the inclusion of the royalty payments in its rates. R. 10403. Thereafter, in a separate case at the Commission, El Paso sought authority to charge its customers rates that included the higher overriding royalty payments.

The Commission had unquestioned jurisdiction to deny the recovery of the royalty payments in El Paso's rates. Yet in 1977 the Commission authorized El Paso to include the higher royalties in its rates, finding the royalty costs to have been prudently incurred and the resulting rate settlement between El Paso and its customers to be reasonable and proper and in the public interest. *El Paso Natural Gas Co.*, 57 F.P.C. 989, 998-1001, 1007-08 (1977). The customers of El Paso, including Petitioners here, supported this Commission Order and did not seek review of this or any subsequent order approving the inclusion of the royalties in El Paso's rates.[14]

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[13] In June, 1977, less than five months after the District Court entered judgment, the Commission instituted a proceeding on the same issue decided by the District Court: federal jurisdiction over the lease sale agreements. El Paso Natural Gas Co., 58 F.P.C. 2181 (1977). Respondents argued before the Court of Appeals on review of that Commission Order that the Commission had prejudged the case and that the doctrines of *res judicata* and collateral estoppel precluded the Commission from retrying the jurisdiction issue. The Court of Appeals allowed the Commission proceedings to go forward. Tenneco Oil Co. v. FERC, 580 F.2d 722 (5th Cir. 1978) (App. 137a-141a). Contrary to the argument of Petitioners Pacific Gas & Electric Company ("PG&E") and Southern California Gas Company ("So Cal Gas"), however, the Court of Appeals specifically held below that its decision to allow the Commission to proceed was *not* a reference of the case to the Commission under the doctrine of primary jurisdiction. App. 19a.

[14] *See* El Paso Natural Gas Co., Docket No. RP79-12 (Further Extension), *et al.*, Unreported Letter Order (August 28, 1983); El

The United States District Court for the Western District of Texas held that the lease sales were not jurisdictional sales of gas under *Rayne Field. El Paso Natural Gas Co.* v. *Sun Oil Co.*, 426 F. Supp. 963 (W.D. Tex. 1977) (App 121a-136a). The District Court found that the leases were not "proven," the leases were not "substantially developed," and the lease sales were not the "economic equivalent" of a gas sales contract. App. 131a-133a. Three years later, the Commission found the lease sale agreements to be jurisdictional sales of gas, holding that they were the "economic equivalent" of sales of gas. *El Paso Natural Gas Co.*, 12 F.E.R.C. (CCH) ¶ 61,297 (1980) (App. 21a-31a).

On review of both decisions, the United States Court of Appeals for the Fifth Circuit found that the lease sales were not subject to Commission jurisdiction, applying the standards of *Rayne Field. El Paso Natural Gas Co.* v. *Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983) (App. 1a-19a). The Court of Appeals reversed the Commission ruling, holding that the Commission misapplied the applicable law and that its decision was not supported by substantial evidence. App. 19a. The District Court's opinion was affirmed. *Id.*

For reasons that are not clear, some Petitioners take the position that the Court of Appeals determined that the leases were proven and that the lease sales were the economic equivalent of a gas sales contract. This is not correct. The District Court specifically found that the leasehold reserves were *not* proven and that the agreements were *not* the economic equivalent of sales of gas. App. 131a-133a. The Court of Appeals affirmed the District Court. App. 19a. All the Court of Appeals can be read to say is that reserves *in the San Juan Basin* "may

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Paso Natural Gas Co., 11 F.E.R.C. (CCH) ¶ 61,215 (1980); El Paso Natural Gas Co., 8 F.E.R.C. (CCH) ¶ 62,023 (1979); El Paso Natural Gas Co., Docket No. RP78-18, Unreported Letter Order (September 5, 1978); El Paso Natural Gas Co., 59 F.P.C. 1290 (1977); El Paso Natural Gas Co., 58 F.P.C. 1978 (1977).

well have been 'proven' at least within reasonable estimates," App. 15a, but only for purposes of demonstrating the inaccuracy of the application of the jurisdictional standard by the Commission. The Court of Appeals did not hold that the leasehold reserves themselves were proven. Indeed, the Court of Appeals specifically affirmed the District Court finding that "actual drilling is the only method of definitely locating recoverable gas saturations." App. 9a.[15]

Equally, the Court of Appeals did not find the lease sale transactions to be the economic equivalent of jurisdictional sales. Rather, the Court of Appeals found that the "economic" test applied by the Commission was so broad as to convert every lease transaction involving an interstate pipeline into a jurisdictional sale if it "ultimately results in successful production and disposition of gas in interstate commerce." App. 14a. The Court of Appeals properly rejected the Commission's formulation as an incorrect application of *Rayne Field*. *Id.*[16]

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[15] Overwhelming evidence supports the District Court's finding that the leasehold reserves were not "proven," whether or not reserves in the San Juan Basin generally were " 'proven' within reasonable estimates." App. 15a. Among the most compelling is a memorandum written by a vice-president of PG&E, one of the Petitioners herein, more than a month *after* the closing of GLA-47. In it, he noted that the reservoir engineering firm of DeGolyer and MacNaughton, which was retained by PG&E and So Cal Gas to make reserve estimates in the event the customers were called upon to finance El Paso's drilling program on the acreage, reported that while there appeared to be "plenty of gas in the Blanco area as a whole . . . further drilling will be necessary before the reserves can be classified as proven." R. 8728-29.

[16] Contrary to its position in this case, in *Webb*, the Commission *rejected* the argument that some of these same lease sale agreements were the economic equivalent of sales of gas. The Commission stated: "The transactions arose out of the needs of the parties rather than being almost wholly a rearrangement of payments, as in *Rayne*, to accomplish the same result as a conventional sale." 49 F.P.C. at 26.

No new principle of law was involved in the Court of Appeals decision. It was not a case of first impression, this Court having spoken. No issue of deference to some federal agency is raised here. The Court of Appeals provided judicial review to determine whether the law was correctly applied and whether there was substantial evidence to support the agency's findings. Where, as here, review involved application of the substantial evidence standard to the Commission's findings, this Court has held that the responsibility rests with the Court of Appeals. This Court intervenes only in the " 'rare instance when the standard appears to have been misapprehended or grossly misapplied.' " *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-310 (1974) (citation omitted).

The Commission now argues to delete the standard of "proven and substantially developed" from the *Rayne Field* test, claiming that the Court of Appeals decision creates a "gap" in the Commission's regulatory authority. FERC Pet. at 20. But the Commission applied and relied upon the "gap" of substantial development in a case just prior to this one in order to allow a pipeline to acquire leases without subjecting the lease seller to jurisdiction. *See Texas Gas Transmission Corp.*, 3 F.E.R.C. (CCH) ¶ 61,135 (1978) (discussed hereinafter at 13-14). Reliance upon this standard in one case and claiming that the standard creates a "gap" in another constitutes an administrative double standard.

At about the same time as the Court of Appeals decision below, this Court issued its decision in *Public Service Commission of New York* v. *Mid-Louisiana Gas Co.*, ___ U.S. ___, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983) ("*Mid-Louisiana*"). Commencing October 1, 1983, El Paso implemented the *Mid-Louisiana* decision by including in its rates certain prices under Title I of the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3333 (1982) ("NGPA"), for most of its pipeline production, including production from these leases. Based upon its implementation of *Mid-Louisiana*, El Paso now complains that it will have to absorb the overriding royalty payments to Respondents and incur a loss unless the Court of Appeals

decision is reversed.[17] Although El Paso complains that the impact of *Mid-Louisiana* upon its operation of these leases is a loss, El Paso's records indicate that it stands to gain billions of dollars in additional revenues based upon its implementation of that decision.[18]

As a consequence of El Paso's implementation of the *Mid-Louisiana* decision in its rate cases before the Commission, customer rates for El Paso's company-owned gas have increased and will remain at a higher level regardless of what happens to the Court of Appeals decision below. Both the Commission and El Paso concede that, for the future, the rates to El Paso's customers will remain the same, either way.[19]

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[17] On this basis, El Paso filed suit in a Texas State District Court claiming a contractual right under the lease sale agreements to reconvey the properties to the overriding royalty owners. El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist. Ct. Harris County, Texas, 11th Jud. Dist., judgment entered Feb. 27, 1984). El Paso's attempted abandonment of these properties prompted California to contend in its Petition that the California customers would lose a supply of gas (California Pet. at 13-14), but the trial judge has entered judgment for the royalty owners, thereby preventing El Paso from alienating the leases. Significantly, El Paso's purported authority to reassign the leases was never called to the attention of the Commission in this case or in El Paso's rate cases.

[18] In this connection, El Paso claims that its exposure is great but cannot be quantified. El Paso Pet. at 11. This is strange. In evidence in *El Paso Natural Gas Co.* v. *Tenneco Oil Co., et al.*, No. 83-50539, is an exhibit (Tenneco/Conoco No. 208A) that is the official, in-house projection by El Paso. It states that El Paso stands to increase its revenues from its customers as a result of this Court's decision in the *Mid-Louisiana* case over the amount it was collecting on a cost of service basis by some $4.6 billion over the next twenty years. If, this report claims, El Paso has to continue to honor its royalty payments, it will nevertheless realize a net $3.8 billion in additional revenues out of the $4.6 billion increase in the rates that it will collect from its customers.

[19] *See* FERC Pet. at 21; El Paso Pet. at 10-11. The Commission *may* allow a rate increase pursuant to its authority to grant special

The Court of Appeals decision does not affect the Commission's authority to set El Paso's rates to its customers for gas from El Paso's own leases either for past or for future periods.[20] The Commission and those of El Paso's customers that are Petitioners herein should not be allowed to second guess their own past decision not to challenge the inclusion of these royalties in El Paso's rates, and indeed affirmatively to approve them as just and reasonable and prudently incurred.

For the future, this case does not determine whether the customers will bear these royalties. The question is whose *stockholders* (or, which individuals, partnerships, trusts and estates—also owners of these overriding royalties) enjoy the benefits of the monies attributable to these royalties: El Paso's or Respondents'.

Respondents respectfully submit that this is not a case warranting this Court's review.

REASONS WHY THE PETITIONS SHOULD BE DENIED

The basic issue decided by the Court of Appeals below was whether the lease sale agreements constitute *Rayne Field* transactions that are subject to Commission jurisdiction. The Court of Appeals properly found that they do not.

In *Rayne Field*, this Court determined that lease transactions are subject to Commission jurisdiction if the following questions all are answered in the affirmative:

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relief on the basis of increased royalty obligations. *See* FERC v. Pennzoil Producing Co., 439 U.S. 508 (1979). No such increase has been sought and, in any event, any application will be subject to judicial review. It is interesting to note that El Paso's chief company witnesses before the Texas State District Court in *El Paso Natural Gas Co.* v. *Tenneco Oil Co., et al.*, No. 83-50539, testified in December, 1983, and January, 1984, that special relief would not be granted to El Paso on the basis of these overriding royalties.

[20] El Paso's rates are regulated by the Commission under Section 4 and Section 5 of the Natural Gas Act, 15 U.S.C. §§ 717c, d (1982), and Section 601 of the NGPA, 15 U.S.C. § 3431 (1982).

1. Did the transaction involve the transfer of proven and substantially developed reserves?
2. Was the transaction the economic equivalent of a sale of gas?
3. Was the transfer to an interstate pipeline for the purpose of interstate transmission and sale?

See Rayne Field, 381 U.S. at 401; *Ship Shoal*, 370 F.2d at 62.

As to the test of "proven and substantially developed reserves," the Court of Appeals affirmed the District Court, which found that the reserves were neither proven nor substantially developed. App. 131a-133a. The Court of Appeals ruled:

> Specifically, we hold the reserves underlying the leaseholds were not substantially developed at the time the lease sales were executed because of the lack of "imminent ability to produce in commercial quantities." App. 15a (citation omitted).

As to the test of "economic equivalent of a sale of gas," the Court of Appeals affirmed the District Court, which found that the transactions were not the economic equivalent of sales of gas. App. 133a. The Court also held that the Commission's reliance upon an "economic equivalency" standard was erroneous. The Court of Appeals found that the Commission had "elevated the first prong [of the *Rayne Field* test]—economic equivalency—from a component in the *Rayne Field* test to the determinative factor on the issue." App. 12a-13a. The Court of Appeals continued:

> Carried to its logical conclusion, the Commission's economic equivalency/commercial realities approach could render any sale of lease rights to an interstate pipeline company jurisdictional merely because the transaction ultimately results in successful production and disposition of gas in interstate commerce. App. 14a.

To support their petitions filed in this Court, the Petitioners do not so much attack the underlying factual basis for the Court of Appeals decision as they rely upon an unprecedented modifi-

cation of the *Rayne Field* standard, as well as a mischaracterization of the Court of Appeals decision. The Petitioners' "Questions Presented" demonstrate these distortions.

First, some Petitioners' "Questions Presented" *ignore* the substantial development test that has been relied upon by the Commission and the courts as an essential element of the three-part jurisdictional standard.[21] The Questions do not even challenge the holding of the Court of Appeals that the lease sale reserves were not substantially developed.

Second, the "Questions Presented" erroneously assert that the Court of Appeals found the lease sale reserves to be "proven" and found the agreements to be the "economic equivalent" of sales of gas. As demonstrated, the Court of Appeals did not so find.

Contrary to the Petitioners' assertions, the Court of Appeals decision does not interfere with the Commission's authority to regulate the rates for sales of gas from these leases. For all periods prior to and after this Court's decision in *Mid-Louisiana*, the Commission has had the power to establish the rates for sales of this gas. Moreover, based upon the passage of the NGPA and the decision in *Mid-Louisiana*, Respondents respectfully submit that the Court of Appeals decision is prospectively moot.

1. The Court of Appeals Properly Applied the *Rayne Field* Standard

In *Rayne Field*, this Court ruled that "the significant and determinative economic fact" surrounding the lease sale agreement at issue was that it involved "a proven and substantially developed field" and "accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other states." 381 U.S. at 401. The lease sale in *Rayne Field* involved a definable volume of gas, such that it was *gas*,

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[21] Only the Petition of the Public Utility Commissioner of Oregon in No. 83-1432 even *mentions* the substantial development test in its "Question Presented."

rather than merely the right to explore for and develop potential gas reserves, that was transferred. In *Rayne Field*, 19 out of a possible 26 wells had been drilled on the subject acreage. *Id.* at 396 n. 3. Substantial development of the leasehold acreage permitted estimates of reserves to be the basis of the purchase price for the leases. This Court stated:

> The substantiality of development is a relevant consideration, for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce which, as Phillips held, the Act has affirmatively placed within Commission jurisdiction. *Id.* at 403.

By focusing on the substantiality of development of the leasehold reserves, this Court established a logical standard for determining equivalence to a sale of gas. If substantial development of the underlying reserves does not exist at the time of the lease transfer, a sale of gas in place is impossible because a definable volume of gas is uncertain, and estimates of reserves cannot be relied upon by the parties to the transfer.[22]

The Commission now argues to ignore the *Rayne Field* requirement that the leases transferred be "proven and substantially developed," claiming that by relying on this standard the Court of Appeals has created a "gap" in the Commission's regulatory authority. FERC Pet. at 20. Yet the Commission relied upon the "gap" of substantial development in a case just prior to this one in order to allow a pipeline to acquire leases without subjecting the lease seller to jurisdiction.

In *Texas Gas Transmission Corp.*, 3 F.E.R.C. (CCH) ¶ 61,135 (1978), the Commission concluded that because only 14 out of the 50 wells drilled on the leasehold acreage had been

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[22] In *Rayne Field*, *Bastian Bay* and *Ship Shoal*, the interstate pipelines agreed to pay a lump sum for the leases based upon an agreed upon estimate of reserves. In *Ship Shoal*, for example, the pipeline agreed to pay $97 million based upon an agreed reserve estimate. *Ship Shoal*, 370 F.2d at 60. By contrast, El Paso paid nothing to the lease owners for the leases in the San Juan Basin. A lump sum payment for reserves would have been impossible due to the minimal drilling that had occurred on the vast lease acreage.

completed, and 50 more wells were to be drilled, the subject acreage was "essentially undeveloped" at the time the leases were transferred, and the transfer did not constitute a jurisdictional sale. The Commission stated:

> Since the Loe interests had not sufficiently developed the field to be able to conduct economically feasible wellhead arrangements, Loe could not have made a conventional wellhead sale to Memphis if the parties had so desired. Only 14 wells had been completed and only 10 of these were productive, it is indicated, and the remaining wells and intended wells were in different states of disrepair. *Clearly, these are essentially undeveloped reserves requiring further development for feasible production.* It is indicated that Memphis is presently engaged in a program to drill 10 new wells and to rework 20 old wells and drilling activity is already to a depth of more than 4,000 feet, or almost double the depth of the wells acquired from Loe. *Except for the small volume of actual production, all indications are that the subject reserves are essentially undeveloped.* Memphis did not acquire a known volume of developed reserves, and the purchase price was not tied to the level of any future production of the magnitude of reserves ultimately discovered. Accordingly, in our view, the sale of reserves by Loe to Memphis does not constitute a sale for resale in interstate commerce requiring a certificate under Section 7(c) of the Natural Gas Act. 3 F.E.R.C. at 61,405-406 (emphasis added).

As in *Texas Gas*, a "known volume of developed reserves" did not exist under the lease sale acreage transferred to El Paso. Unlike *Texas Gas*, however, in which "the purchase price was not tied to the level of any future production of the magnitude of reserves ultimately discovered," *id.*, the lease sale agreements herein did not even establish a purchase price for the leases. If anything, the inability to establish a purchase price demonstrates that the leases in this case were *less* developed than in *Texas Gas*. A question of fundamental fairness arises when the Commission chooses to apply the substantial development test when it wishes to approve a lease sale, as in *Texas Gas*, and to ignore it when, as in this case, it does not like the result.

Please compare the facts in the *Texas Gas* case with those before the Court of Appeals below. The largest and first of the El Paso acquisitions, GLA-47, the Delhi lease sale, had 15 wells drilled into the Mesa Verde formation on the date of execution and 16 on the date of closing. App. 66a. Full development of the 102,000 acres conveyed, under then-existing spacing requirements, would have required in excess of another 300 wells; full development under today's spacing requirements would have necessitated more than twice that number of wells.[23] Similarly, the largest and first of the Northwest lease acquisitions had *no* wells on the 188,000 acres on the date of execution. App. 16a. On the closing date, only 75 out of a possible 590 wells, under the existing spacing requirements, or approximately 1200 wells, under today's spacing requirements, had been drilled. App. 85a n.97.

These numbers, like the numbers in *Texas Gas*, are far different from those confronting this Court in *Rayne Field* and *Bastian Bay*, or the court of appeals in *Ship Shoal*. In *Rayne Field*, 19 out of a possible 26 wells had been drilled on the lease acreage. 381 U.S. at 396 n.3. In *Bastian Bay*, 32 of a possible 39 wells had been drilled on the twelve contiguous leases conveyed. R. 14126.[24] In the *Ship Shoal* case, 17 wells had been drilled at the time of the transaction on the single lease of approximately 3,000 acres. 370 F.2d at 59-60; R. 21841. By comparison, at the time GLA-47 was signed, only 24 total wells

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[23] The Pictured Cliffs formation, the only other formation with wells drilled thereon, had 9 wells drilled both at the time of execution and at the time of closing of GLA-47. App. 66a. Under applicable spacing requirements (which are the same today as in 1952), more than 600 Pictured Cliffs wells were necessary for full development.

[24] *See also* the discussion of the *Bastian Bay* facts by the Court of Appeals in Pan American Petroleum Corp. v. FPC, 339 F.2d 694, 695 (10th Cir. 1964), *rev'd*, 381 U.S. 762 (1965).

had been drilled on over 102,000 acres, with only 20 of the 146 non-contiguous leases conveyed having even one well drilled thereon. R. 3957-4127.[25]

Please look at the map lodged with the Clerk by Respondents.[26] Each small square is one square mile. Each large square is six miles square. For perspective, maps of Rhode Island and the District of Columbia, drawn to scale, are superimposed. You will note that the leases (shaded in blue) transferred by GLA-47, the original Delhi lease sale, are not contiguous and, in fact, are scattered over an axis of about 56 miles by 26 miles. There is no way that a contention can be made that

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[25] In their discussion of the "trilogy" of jurisdictional cases, Petitioners inject a prior transaction between El Paso and Delhi as a purported example of an earlier *Rayne Field* transaction between the parties. Petitioners would have this Court believe that the "Barker Dome" transaction was the predicate for and was similar to the lease sale agreements at issue herein. As a threshold matter, that transaction never has been joined in the instant case nor has it ever been found by the Commission or any court to constitute a *Rayne Field* transaction. Moreover, the Presiding Administrative Law Judge noted in his Initial Decision below that the Barker Dome transaction "is not involved in this proceeding, and is substantially different in content from the El Paso lease-sale contracts that were executed later." App. 56a. The Barker Dome transaction involved a geographical and geological area distinct from the area of the San Juan Basin covered by the lease sale agreements at issue herein.

The Barker Dome transaction did not, as Petitioners claim, represent an attempt to avoid Commission jurisdiction. The Administrative Law Judge's Initial Decision acknowledges (App. 46a-47a n. 29) that the concern expressed over Commission jurisdiction was in connection with an earlier agreement, later rescinded, that would have made Delhi a joint owner of El Paso's pipeline extending from the Barker Dome Field area. The pipeline affiliation was terminated long before the Barker Dome lease sale took place. The Commission adopted the finding of the Administrative Law Judge. App. 24a.

[26] The map is a copy of Exhibit 40-EP-1911 (GLA-47, Mesa Verde formation as of March 1, 1952) in the District Court and Commission proceedings below, R. 9972, with overlay added.

a well drilled can produce gas from leases up to 20 miles away. Indeed, the evidence shows that up to four wells per square mile are required to produce the gas from the Mesa Verde formation,[27] so one well cannot even produce the gas from one square mile. In the Pictured Cliffs formation, above the Mesa Verde, even fewer wells had been drilled.

The Court of Appeals properly noted that a comparison of the number of wells in place at the time of the lease sales' execution and the number of wells necessary to complete production from the lease sale acreage is relevant to the substantiality of development. App. 16a-17a. The more wells that must be drilled *after* the transfer of the leases, the less the acreage transferred is imminently capable of producing gas in commercial quantities, and, as this Court stated in *Rayne Field*, "the more that must be done before the gas begins its interstate journey." 381 U.S. at 403.[28]

Petitioners erroneously assert that the drilling undertaken by El Paso *after* the execution of the lease sale agreements indicates that the reserves were imminently producible in commercial quantities. Petitioners rely upon estimates made at the time GLA-47 was executed indicating that large volumes of gas could be delivered into El Paso's pipeline within a few years after execution. FERC Pet. at 19. These estimates cited by Petitioners were predicated upon drilling and development

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[27] The Court of Appeals properly noted that in 1974, El Paso applied for and obtained permission from the New Mexico Oil Conservation Commission to increase to two the number of wells permitted to be drilled on a 320-acre unit in the Mesa Verde formation. App. 16a. The State Commission order was based in part upon testimony sponsored by El Paso that rapid depletion of the Mesa Verde formation was not possible under existing 320-acre spacing. R. 16664-16736.

[28] The Court of Appeals found that in 1976, 736 wells had been drilled on the GLA-47 acreage compared to the 24 wells that had been drilled at the time GLA-47 was executed in 1952. In 1977, 365 wells had been drilled on the acreage transferred to Northwest by Phillips Petroleum Company under PLA-5, compared to *none* at the time PLA-5 was executed in 1953. App. 15a-16a.

to be conducted by El Paso *after* it acquired the leases.[29] Indeed, the rigorous development program undertaken by El Paso after the transfer of the leases, ultimately resulting in more than 3,200 wells on the lease acreage, is a measure, more than anything, of the *absence* of development that existed on the lease sale acreage at the time the agreements were executed.

El Paso, Northwest and others argue that the jurisdictional standard must be modified to eliminate the requirement that the leases be "proven and substantially developed" in order to prevent producers and pipelines, like El Paso and Northwest, from entering into lease sales that violate the Natural Gas Act. While it may seem strange for the two pipelines to make this claim about their own transactions, it seems most unlikely that the Commission can sustain such a claim, since not only has the Commission so recently applied the test of "substantial development" in order to allow an interstate pipeline to acquire leases without subjecting the royalty owner to jurisdiction as a seller of gas, *see Texas Gas*, but the Commission has scrutinized these lease sale agreements on a constant and continuing basis since their inception in the 1950's.

If El Paso and the other petitioners were to succeed in persuading this Court to alter the jurisdictional standard retroactively, the result would be not the closing of a claimed "regulatory gap," but rather that any interstate pipeline that has ever acquired leases that were subsequently successfully developed would be in violation of the Natural Gas Act. A change in the standard would call into question all of the pipeline production now owned by interstate pipelines, having acquired leases that were not substantially developed. According to the latest summary of interstate pipelines' gas supply, almost fourteen percent of total domestic reserves is owned by

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[29] The studies cited by the Petitioners indicating the volumes of gas believed to be producible from the GLA-47 acreage in four years required the drilling, *by El Paso*, of more than 250 wells. R. 9737-9746.

interstate pipelines.[30] As the Court of Appeals pointed out, under the Commission's economic equivalency test in this case, every lease sale to an interstate pipeline would be subjected to jurisdiction under the Natural Gas Act. App. 14a.

Contrary to the position it now takes, the Commission itself has found in two separate proceedings that at the time of these very lease sales, El Paso did not offer the owners of these leases adequate incentives to explore for gas and to develop and sell any reserves which might exist, under conventional sales contracts. *See William G. Webb*, 49 F.P.C. at 23, 25: *El Paso Natural Gas Co.*, 57 F.P.C. at 998. The Commission held that acquisitions of these leases "were the only means El Paso was able to attach additional dry gas reserves because the conventional gas purchase agreements failed to provide adequate incentives to the producer." *El Paso Natural Gas Co.*, 57 F.P.C. at 998.

Some Petitioners claim that El Paso was *forced* to accept these lease sales in the 1950's because of the market power of the Respondents. California Pet. at 5; El Paso Pet. at 5. This is ridiculous. Since the early 1950's, El Paso has been the largest purchaser *and* the largest producer of gas in the San Juan Basin of New Mexico. When another pipeline company moved into the Basin and began to compete for gas leases and contracts and threatened El Paso's monopoly on the California market, El Paso bought out this competitor and further reduced competition, in violation of the antitrust laws. *See U.S. v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).[31]

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[30] Energy Information Administration, Department of Energy, Gas Supplies of Interstate Natural Gas Pipeline Companies, 1982, at 12, Table 3 (October, 1983).

[31] After a divestiture that was ordered by this Court (*see* U.S. v. El Paso Natural Gas Co., 376 U.S. at 662; U.S. v. El Paso Natural Gas Co., 358 F. Supp. 820 (D. Colo. 1972), *aff'd*, 410 U.S. 962 (1973)), the other pipeline is now known as Northwest Pipeline Corporation, a Petitioner in this proceeding.

2. The Court of Appeals Decision Does Not Expand the "Production or Gathering" Exemption of Section 1(b) of the Natural Gas Act,

Contrary to the Petitioners' claims, the Court of Appeals decision below does not expand the "production or gathering" exemption of Section 1(b) of the Natural Gas Act. 15 U.S.C. § 717(b) (1982). Rather, the decision below recognizes that lease agreements such as these, by which undeveloped leases are transferred, precede even the production and gathering of natural gas. Because the reserves underlying the subject leases were undeveloped at the time of the lease sales, no "wholesale" of gas within the meaning of *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 682 (1954), was possible.

By arguing that the "production or gathering" exemption no longer exists with respect to undeveloped leases transferred to interstate pipelines, the Commission contradicts *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949) ("*Panhandle*"), in which this Court held that the "transfer of undeveloped gas leases is an activity related to the production and gathering of natural gas and beyond the coverage of the Act . . . ." 337 U.S. at 515. Accepting the Commission's argument would also resurrect the Commission determination, *rejected* by the court of appeals in *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972), that all lease sale agreements are jurisdictional sales of gas subject to Commission jurisdiction if the gas ultimately is sold in interstate commerce for resale. 463 F.2d at 258-59, 263.

The Petitioners' arguments improperly minimize the distinction drawn by this Court between *Rayne Field* and *Panhandle*, in which this Court ruled that the transfer of undeveloped leases from an interstate pipeline to an intrastate pipeline affiliate was not within Commission jurisdiction. The Court of Appeals properly noted: "[t]he Supreme Court emphasized the difference in the degree in development in explaining why it held the transactions jurisdictional in *Rayne*

Field, but nonjurisdictional in *Panhandle*." App. 15a (citation omitted).[32]

In this case, due to the minimal amount of drilling that had been conducted on only a few of the transferred leases, most of which had no wells at all, sales of commercial quantities of gas (indeed, even production and gathering of gas) was not possible upon the transfers except in small amounts on a few of the leases.[33] The terms of the lease sale agreements reflect these conditions.[34] In *Mobil*, the court noted that a gas lease "transfers only the right to explore, develop, and market if exploration is successful . . . ." 463 F.2d at 262.[35] In this case, where all

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[32] In *Rayne Field* this Court stated: "To recognize no differences between the Panhandle transfers and those in issue here . . . would turn the case-by-case process against itself." 381 U.S. at 404.

[33] Petitioners argue that the Court of Appeals' focus on the absence of substantial development overlooks the "undisputed economic fact" that a producer will not commence development of his leasehold acreage until he has obtained a market for his gas and a gas sales contract has been secured. FERC Pet. at 17 n.15. Yet in *Texas Gas*, the Commission *relied* on the fact that insufficient development had occurred on the leasehold acreage in order "to conduct economically feasible wellhead arrangements." The Commission stated that the lessor "could not have made a conventional wellhead sale . . . if the parties had so desired." 3 F.E.R.C. at 61,405-406.

[34] The terms of the agreements imposed drilling obligations upon El Paso and provided for payment of overriding royalties based only upon the gas produced. If no gas was produced, no royalties were due. Indeed, as the District Court found, the agreements provided that if drilling by El Paso indicated that acreage would not be productive of gas in commercial quantities, El Paso promptly could turn the lease acreage back. App. 126a, 132a.

[35] The court held in *Mobil* that a royalty interest retained by the lessor is not sufficient to make him a seller of gas. The court stated: "an economic interest in the proceeds of a sale, unaccompanied by authority to determine the incidents of the sale, does not make one a seller." 463 F.2d at 262. In this case, like *Mobil*, the only economic interest retained by the lease owners under the agreements was an overriding royalty. Unlike Louisiana Land & Exploration Co. v.

drilling and development was undertaken by El Paso, what was transferred was, as in *Mobil*, the right to explore for gas, *not* gas itself.

3. The Court of Appeals Decision Neither Affects the Commission's Authority To Regulate the Rates Charged Consumers for Natural Gas Nor Jeopardizes Gas Supply, as California Contends

Petitioners claim that unless the Court of Appeals decision is overturned, the Commission will be precluded from regulating the rates for natural gas charged to consumers in several western states. FERC Pet. at 10-11. This claim ignores the regulatory framework under the Natural Gas Act, under which the gas produced and sold by El Paso, "pipeline-owned" production, was regulated even *before* the *Phillips* decision and has been regulated continuously since. The Commission *always* has had jurisdiction over the rates charged by El Paso to its customers for gas from its own leases; nothing decided by the Court of Appeals operates to change in any manner this fact.

a. Prior to *Mid-Louisiana*, the Commission permitted El Paso to include the overriding royalties in its rates, and as recently as 1977 determined that El Paso was "prudent" in acquiring the leases in order to obtain a needed gas supply in the San Juan Basin. *El Paso Natural Gas Co.*, 57 F.P.C. at 998. In fact, the Commission commended El Paso in its 1977 order for the "degree of innovation and imagination" demonstrated in entering into the original agreements and the 1974 settlement agreements. *Id.* El Paso's customers did not challenge the continuing inclusion of the overriding royalties in any El Paso rate case, to and including September 30, 1983, although they had a right and an opportunity to do so.[36]

FERC, 574 F.2d 204 (5th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979), relied upon by Petitioners, in which the lessors retained control over the identity of the purchaser of the lessee's gas, in this case all control over the incidents of any sales of gas produced from the lease sale acreage was transferred to El Paso.

[36] *See* n. 14, *supra*.

Consistent approval of El Paso's rates illustrates how hollow is the claim that "the decision of the Court of Appeals has deprived consumers in the western states, especially California," of the protection of the Natural Gas Act. California Pet. at 13. Nothing in the Court of Appeals decision requires that the California customers or any customers of El Paso pay one cent of the overriding royalties. Payment of the overriding royalties is an obligation of the corporate shareholders of El Paso, and any charge for the overriding royalties in El Paso's rates is a separate matter entrusted to the Commission through its rate making jurisdiction.

With respect to potential refunds for past periods in the event the lease sale agreements are found to be jurisdictional sales of gas, each of the petitions claims, more or less, that the Court of Appeals decision has deprived the pipelines' customers of hundreds of millions, even a billion dollars in refunds. *See, e.g.*, FERC Pet. at 21. These claims have no basis in any decision by the Commission. When the Commission issued its order determining that the lease sales were subject to Commission jurisdiction, it ordered that proceedings be commenced to determine a remedy. The Commission stated:

> The basic issues to be addressed on remand are (1) whether and if so to what extent were the payments made by [the pipelines] to the overriding royalty owners excessive and therefore unlawful; (2) what *if any* amounts should be required to be refunded . . .; and (3) what level of royalties should be approved for the future? App. 30a (emphasis added).

The remedy issue never has been tried. No determination has been made, in any forum, that payments to the overriding royalty owners were excessive or that any refunds will be paid.

It is somewhat disingenuous for Petitioners to argue now that the Court of Appeals decision in 1983 deprived El Paso's customers of the benefits of the Natural Gas Act. It is also somewhat strained for the Commission to suggest that the royalty rate is too high, since the royalties agreed upon by El Paso at arm's length in the 1974 settlement agreements were, in the Commission's own words, "just and reasonable." *El Paso Natural Gas Co.*, 58 F.P.C. 2181, 2184 (1977).

The petitions by some of the customers of El Paso, specifically PG&E and So Cal Gas, also leave a certain candor behind. While PG&E and So Cal Gas assert that the royalty rate approved by the Commission (without objection) has burdened their customers (PG&E, So Cal Gas Pet. at 14), they do not inform this Court that they have been purchasing interstate gas from *their own affiliates* in preference to El Paso's gas even though El Paso's gas has been their cheapest source of interstate gas, even with the small component for the overriding royalties. The Commission now is investigating this situation in *Pacific Gas Transmission Company*, Docket Nos. RP83-113-000, *et al.* (Order denying rehearing of order consolidating proceedings entered April 2, 1984). At issue are the "minimum bills" of the interstate pipelines, including El Paso, Transwestern Pipeline Company and affiliates of PG&E and So Cal Gas. In that consolidated docket, on March 2, 1984, El Paso itself said:

> The fact that minimum bill/minimum take provisions of interstate pipelines serving the California market have caused untenable and unnecessary costs and burdens to be borne by California consumers is beyond dispute in these proceedings. Also beyond dispute is the fact that, because of such provisions, the loss of load in the California market has been borne almost entirely by El Paso despite El Paso's being the lowest cost out-of-state supplier to that market.[37]

b. Petitioners fail to inform this Court that under its implementation of the *Mid-Louisiana* decision, El Paso stands to increase its revenues from its customers, including its California customers, for pipeline production, which includes the leases involved in this suit, by more than $4.6 billion over the next twenty years. By El Paso's own estimate, if El Paso does not convert these lease sale agreements into jurisdictional sales of gas, El Paso still will realize more than $3.8 billion out of the over $4.6 billion in additional revenues that it will collect from its customers under its implementation of *Mid-*

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[37] Pacific Gas Transmission Company, *et al.*, Docket Nos. RP83-113-000, *et al.*, "Motion by El Paso Natural Gas Company for Interim Initial Decision" at 17 (filed March 2, 1984).

Louisiana.[38] In any event, according to El Paso and the Commission, the California consumer will pay the same rate for gas after October 1, 1983, albeit a much higher rate, regardless of the outcome of the instant proceeding. El Paso Pet. at 10-11; FERC Pet. at 21.

A claim is made by California that the Court of Appeals somehow has forced El Paso to attempt to reassign the gas leases to the royalty owners in the Texas State District Court proceedings, thereby risking a loss of supply to the California customers. California Pet. at 13-14. Yet it was the corporate decision of El Paso, in order to maximize its profit potential under the *Mid-Louisiana* decision—not the decision of the Court of Appeals below—that led El Paso to attempt to reassign the leases to the royalty owners. The royalty owners undertook to defeat El Paso's attempt to reassign the leases, an effort they have in common with the California consumers. The State District Court Judge entered a judgment on February 27, 1984, holding that El Paso could not reassign the leases. As a consequence, the concern expressed by California pertaining to the potential loss of gas supply presently is moot.

4. Suggestion Of Prospective Mootness

Respondents respectfully suggest that the decision of the Court of Appeals now is prospectively moot due to: (a) the decision of this Court in *Mid-Louisiana*; and (b) the passage of the NGPA.

a. As a result of this Court's decision in *Mid-Louisiana*, any leases acquired presently or in the future by pipelines for the pipeline itself to develop and produce the gas for sale will be subject to the same regulation as gas sales from independent producer-owned leases. Thus, the decision of the Court of Appeals will have no effect on the customers of interstate pipelines, because the rate charged by the producer—be it an

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[38] *See* Tenneco/Conoco Exhibit 208A admitted into evidence in *El Paso Natural Gas Co.* v. *Tenneco Oil Co., et al.*, No. 83-50539.

independent producer or a pipeline producer—will be subject to the same regulatory constraints. Therefore, the decision of the Court of Appeals is prospectively moot from the effective date of the *Mid-Louisiana* decision.

Furthermore, the Commission asserts that the rates to El Paso's customers resulting from the implementation of the *Mid-Louisiana* decision will remain the same whether the Court of Appeals is affirmed or reversed. FERC Pet. at 21. No better demonstration of prospective mootness is possible.

b. The Commission argued below, but did not bring to this Court's attention in its petition, that the NGPA added the transfer of title to proven reserves to the definition of "first sales" to be subject to the price controls of the NGPA. This is Section 2(22) of the NGPA, 15 U.S.C. § 3301(22) (1982), which provides:

> DELIVER.—The term "deliver" when used with respect to any first sale of natural gas, means the physical delivery from the seller; except that in the case of the sale of proven reserves in place to any interstate pipeline, any intrastate pipeline, any local distribution company, or any user of such natural gas, such term means the transfer of title to such reserves.

Any lease transfers that occur after the effective date of the NGPA, December 1, 1978, are subject to review under this new Act, and the pricing provisions of any sales will be governed by the NGPA. In this circumstance, it will not matter whether the lease sale is or is not subject to the Commission's jurisdiction under the Natural Gas Act, and thus the Court of Appeals decision will have no precedential effect.[39]

5. Pending Issues Not Resolved by the Court of Appeals

Other significant issues were raised and argued below but were not reached by the Court of Appeals in the light of its

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[39] El Paso argues that the passage of this Section somehow indicates that the *Rayne Field* standards of "proven and substantially developed" and "economic equivalency" were no longer operative in 1978. El Paso Pet. at 22-23. This is gainsaid by the fact that in 1978 the Commission applied these very standards in the *Texas Gas* case.

disposition of the case. Thus, these issues are not now before this Court. The Court of Appeals summarized the points as follows:

> (1) since the district court decision preceded the Commission's decision, did it have a *res judicata* effect that bound the Commission? (2) having litigated and lost in the district court, were El Paso and Northwest collaterally estopped from claiming before the Commission that the transactions are jurisdictional? (3) was the Commission bound to treat the transactions as nonjurisdictional because of its prior rulings in connection with such transfers involving some of the same parties and the same basic facts? and (4) should the district court have referred the jurisdictional issue to the Commission under the doctrine of primary jurisdiction? Other subissues argued but not decided are: (a) whether the Commission prejudged the issues, (b) whether the petitions for review in No. 77-2613 concerning the Commission's decision to conduct a show-cause proceeding on the jurisdictional issue should be dismissed for seeking review of nonfinal interlocutory orders, and (c) whether the Commission's resolution of the jurisdictional question should be given only advisory effect in the court of appeals. App. 8a-9a.

CONCLUSION

Petitioners ask this Court to review a finding by the Court of Appeals that the Commission's order was not supported by substantial evidence or, in the alternative, Petitioners seek a retroactive change in the jurisdictional standard established by this Court in *Rayne Field*. Petitioners do not even raise the issue whether the Court of Appeals correctly affirmed the District Court, which held that the leases were not proven, not substantially developed, and that the lease sale agreements were not the economic equivalent of a gas sales contract. Equally, this Court's attention is not directed to the issues not reached by the Court below. El Paso, at least, concedes that even upon a reversal a remand would be required. El Paso Pet. at 25.

For some reason, the Commission did not call this Court's attention, as it did in the Court of Appeals below, to the fact that the NGPA provides a new statutory standard for review-

ing lease sales occurring after November, 1978. Respondents suggest that Section 2 (22) of the NGPA renders the Court of Appeals decision prospectively moot.

So also does the decision of this Court in *Mid-Louisiana* render the Court of Appeals decision prospectively moot. If, as the Commission argues, the rate for sales of gas from pipeline production is now the same as the rate for sales of gas from independent producers, the decision of the Court of Appeals has no effect on the rates charged by El Paso for production from the lease sale properties.

That leaves only a retroactive change, a change that would call into question the jurisdictional status of all leases previously transferred to interstate pipelines, which now constitute some fourteen percent of total gas supply in the United States. Since the Commission itself consistently applied the standards of "proven and substantial development" and "economic equivalency" in 1978 in order to allow a pipeline to acquire leases without subjecting the lease seller to jurisdiction (*Texas Gas*), it is difficult to sustain a claim of a new "regulatory gap." This is particularly true when the principal lease sales involved in this case took place thirty years ago, even before the *Phillips* decision.

No new principle of law is involved here. The Court of Appeals decision only involves application of the test established by this Court in *Rayne Field* to the facts of this case. The Commission, and the Petitioners allied with El Paso in its effort to be relieved of its contractual obligations, decided to allow El Paso to collect the royalties, which the Commission said were "just and reasonable," in its rates. *See El Paso Natural Gas Co.*, 58 F.P.C. at 2184. This decision by the Commission and El Paso's customers passed up this opportunity to reduce their gas costs, should Respondents prevail in this proceeding. That the agreed upon overriding royalties have been included in El Paso's past rates has no bearing on the question whether these leases transferred in the 1950's met the *Rayne Field* test.

The petitions for a writ of certiorari should be denied.

Respectfully submitted,

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